

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201104003**

Release Date: 1/28/2011

Index Number: 2601.00-00

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-115875-10
Date:
October 08, 2010

RE:

Legend:

Trust =
State =
Grantor =
Child A =
Grandchild A =
Grandchild B =
Date 1 =
Date 2 =
Date 3 =
Court A =
Court B =

Statute =

Dear :

This letter responds to your letter, dated April 7, 2010, submitted by your authorized representative, requesting generation-skipping transfer (GST) tax rulings with respect to a conversion of Trust to a unitrust under State law and the creation of two new trusts.

Grantor died testate on Date 1, and pursuant to Grantor's will and a Court A order on Date 2, Trust was established for the primary benefit of Grantor's spouse, Child A, and the issue of Child A. A corporate trustee is currently the sole trustee of Trust. Under the terms of Trust, the trustee may:

pay to, lay out, expend for the benefit of, or make available to any or all of

said persons or their respective personal representatives, from the income of this trust, such sum or sums of money or property as in the absolute discretion the trustee determines to be appropriate, and in such proportions and amounts, without regard to equality of distributions, as the trustees may determine in their absolute discretion.

The trustee also has discretion to pay principal of the trust and in diminution thereof, pay to or for the benefit of Child A such sums from the principal as in the absolute discretion of the trustee, are necessary from time to time to enable her to meet any expenses of herself, her husband or her children, which are of an emergency nature or which are necessary to enable them to maintain a reasonable comfortable standard of living, including but not being limited to for the purpose of providing for the support, care, comfort, medical care, and education of her children and/or assisting her children in commencing a business or professional practice.

Trust terminates upon the earlier of the following conditions: (1) upon the death of the last survivor of a named class (which includes Child A) and Child A leaves no surviving issue; (2) upon the death of the last survivor of a named class (which includes Child A) and the death of Child A's last surviving issue; (3) upon the death of the last survivor of Grantor's spouse and Child A and the youngest surviving child of Child A attains age 45; and (4) 21 years after the death of a class of named individuals, including Child A and Child A's decedents, living at the date of Grantor's death. Upon termination, trust is to be divided per stirpes and distributed to Child A's surviving issue.

Trustee of Trust petitioned Court B to convert Trust into a unitrust with a 5 % payout. State Statute permits a court to convert a trust to a unitrust if the court determines that the conversion will enable the trustee to better carry out the purposes of the trust and that the conversion is in the best interests of the beneficiaries. Statute provides that following conversion of a trust to a unitrust, "income" in the governing instrument means an annual amount equal to a percentage of the net fair market value of the total trust assets averaged over a three-year period.

Trustee of Trust also petitioned Court B to amend Trust to provide for the creation of two new trusts, one for Grandchild A's issue and one for Grandchild B's issue. The purpose of the new trusts is to receive income distributions from Trust intended for the descendants of each respective grandchild. Under the terms of the new trusts, there will be two trustees. During the term of each new trust, the trustees may pay income or corpus to the living descendants of such grandchild, as in the discretion of the trustees is necessary or appropriate. The trustees may take into consideration the grandchild's resources known to the trustees. Any unexpended income will be accumulated. Each respective grandchild will have a special power of appointment over the trust. The new trusts terminate in accordance with the termination provisions above for Trust, with the possibility of earlier termination upon certain conditions. Upon termination, the trustees will distribute any remaining assets outright

at the corporate trustee's discretion to a class consisting of Child A's descendants. Each beneficiary has 30 days after receipt of notice to withdraw any designated share, otherwise the designated share is held in a separate trust for the beneficiary with a general power of appointment.

On Date 1, Grantor was survived by spouse (now deceased), Child A, Grandchild A, and Grandchild B. Grandchild A has three children and Grandchild B has two children. The youngest grandchild is age 43.

Date 1 and Date 2 are before September 25, 1985. No additions (actual or constructive) have been made to Trust since September 25, 1985. Trust is governed by State law. On Date 3, Court A approved the petitions.

You have requested the following rulings: (1) the conversion of Trust into a unitrust will not cause Trust to lose its status as exempt from the GST tax, and (2) creation of and any distributions to the new trusts will not cause Trust or the new trusts to lose their status as exempt from the GST tax.

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611(a) defines the term "generation-skipping transfer" as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless specifically noted, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of

§ 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust. In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)-1 of the Income Tax Regulations.

Section 26.2601-1(b)(4)(i)(E), Example 11, considers a situation where a trust that is otherwise exempt from the GST tax because it was irrevocable prior to September 25, 1985, provides that trust income is payable to A for life and, upon A's death, the remainder is to pass to A's issue, per stirpes. State X, the situs of the trust, then amends its income and principal statute to define income as a unitrust amount of 4% of the fair market value of the trust assets valued annually. The example concludes that the administration of the trust, in accordance with the state statute defining income to be a 4% unitrust amount will not be considered to shift a beneficial interest in the trust. Therefore, the trust will not be subject to the provisions of chapter 13. Further,

under the facts of the example, no trust beneficiary will be treated as having made a gift for federal gift tax purposes, and neither the trust nor any trust beneficiary will be treated as having made a taxable exchange for federal income tax purposes.

The trustees represent that Trust was irrevocable on September 25, 1985 and that there were no additions to Trust after September 25, 1985.

The facts in this case are similar to those set forth in Example 11 of § 26.2601-1(b)(4)(i)(E), which provides that the conversion of an income interest to a unitrust interest pursuant to state statute will not be considered to shift a beneficial interest in a trust for GST purposes. The conversion meets the requirements of State Statute and is pursuant to an order from State Court B. Accordingly, we conclude that the conversion of the income interest in Trust to a unitrust interest will not be considered to shift any beneficial interest in Trust and, therefore, will not cause Trust to lose its status as exempt from the GST tax. We further conclude that the any income distributions to the new trusts will not cause Trust or the new trusts to lose their status as exempt from the GST tax.

We further conclude that transfers of Trust income to the new trusts constitute direct transfers to the respective issue of Grandchild A or Grandchild B, and, accordingly, such recipient is treated as the transferor of their respective contribution to the new trusts for purposes of § 2652.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings in this letter pertaining to the federal generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representatives.

Sincerely,

James F. Hogan
Chief, Branch 4
(Passthroughs & Special Industries)

Enclosure
Copy for § 6110 purposes

cc: